No. 6586

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

D. W. JOHNSTON, as Trustee in Bankruptcy of the Estate of DuPont Milling & Sales Corporation, Bankrupt,

Appellant,

vs.

JOHN P. McLAUGHLIN, Collector of Internal Revenue,

Appellee.

APPELLANT'S PETITION FOR A REHEARING.

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To the Honorable Curtis D. Wilbur, Presiding Judge, and to the Associated Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

Conceiving the questions of law upon which this controversy rests to have been erroneously determined, appellant respectfully petitions the Court for a rehearing. In this behalf appellant respectfully submits the following points.

By admissions in the pleadings and stipulations of fact, these things are definitely established:

(1) The defendant, an officer of the Government, has money to which he is not entitled.

(2) There was no taxable income.

(3) There was no tax to be paid.

(4) The money was not paid as a tax, since there was no tax or taxable income.

(5) Detriment to existing creditors of the corporation resulted from the payment.

(6) One purpose of the false return and payment was to defraud these creditors.

(7) The creditors were in no wise at fault.

(8) This action is in behalf of the creditors, represented by the trustee in bankruptcy as plaintiff.

(9) Rights of the corporation or its stockholders are not involved.

The Court in its opinion says, "This is an action to recover taxes paid." Appellant respectfully submits that that is not true. This is the equitable action for money had and received, against a defendant who received money which in equity and good conscience he ought not to retain. Designating the payment as a tax does not make it so. It is elementary that equity looks through form, and to the substance. In form, there was a payment as of a tax, upon a false return, when there was in fact no taxable income, and no tax. The substance was the payment of money to one to whom there was nothing due. Certainly the Court should look through this form, just as it does through innumerable other colorable transactions in which money of an insolvent is, in fraud of creditors, paid

to another, who, for lack of consideration, has no right in equity or good conscience to retain the money.

Clearly Section 606 of the Revenue Act, a statute concerning recovery of taxes paid, is inapplicable. That statute is not a general law. It is part of the revenue law, and deals only with taxes. Its purpose is to set at rest, by closing agreements, controversies concerning over- and under-payments of taxes. It was never intended to prevent recovery, for creditors of an insolvent, of money of the insolvent fraudulently paid as a tax when there was in fact no tax or income to be taxed. By every principle of law and statutory construction, the transaction here is not within the scope of the statute. Shorn of is false form, the payment was not the payment of a tax, but simply a fraudulent handing over of money of the corporation to one to whom nothing was due, and this without consideration and in fraud of existing creditors. There was here no tax controversy to be set at rest, but merely a colorable payment in fraud of creditors. As in all other cases, the beneficiary of the fraud, who received the fruits of the fraud without consideration, should be held to be a trustee of the fund received. The remedy in such cases is the equitable action for money had and received. The statute of limitations controlling that remedy is that applicable to any other action for money had and received, founded upon fraud. The jurisdiction of the Court arises from its general jurisdiction of actions at law and in equity, and is not controlled by this special statute concerning controversies over taxes. Here there was no tax,

but simply a fraudulent payment in the guise of a tax.

No parallel or precedent for this action is to be found in the reported cases, for the reason that they all involve controversies concerning an over- or under-payment, where there was some tax to be paid. The singularity of this case, founded as it is upon a fraudulent use of the forms of law concerning revenue, should not deter the Court from righting the wrong merely because of use of the revenue law as an instrumentality of the fraud, there being in fact no income to be affected by the revenue law, and hence no tax to be paid. The cloak or guise under which a fraud is perpetrated should never be a determining factor protecting that fraud. Here, by the decision of the Court, a limitation found in the revenue law only, is made to protect the fraud, solely for the reason that the forms of the revenue law were used for the perpetration of the fraud. The inherent power of the Court can not be so limited. Despite the use of this or any other form, the Court should look to the substance of the transaction, and, applying the general underlying principles of law, right the wrong done by the fraud.

It is further said in the opinion that "No person can take advantage of his own wrong." That is an elementary principle, but we conceive it to have no application here. In considering this point it is necessary to keep clearly in mind who will benefit by the judgment sought here. It is also necessary to remember that there were two wrongs. First, the wrong against the Government, by the filing of the false

return. That, however, was a wrong without injury, since there was in fact no income, and therefore no tax due to the Government. The second wrong, the foundation of this action, was to the creditors. It consisted of defrauding the creditors by payment of funds of the insolvent corporation to one to whom nothing was due.

The wrong complained of, the fraud upon creditors, was the act of the corporation or its officers, but the injury was to the creditors. An action by the corporation might have been successfully resisted on the ground that the corporation could not take advantage of its own wrong. But, while both wrongs were the acts of the corporation, the persons injured by the wrong complained of were the then and now existing creditors of the corporation. These creditors have been guilty of no wrong. Righting of the wrong done them will be of no advantage to the wrongdoer, the corporation. A judgment for the plaintiff will but take from the defendant money he received without consideration, and has therefore no right in equity or good conscience to retain, and give that money to creditors of the corporation, who are innocent of any wrong. This will not in any sense right the wrong, but will deprive the beneficiary of the fruits of the wrong, restoring those fruits, not to the corporation, but to creditors of the corporation, who are now and were such at the time of the wrong.

It is no answer to this position to say that the trustee in bankruptcy represents the corporation. In a

sense he does represent the corporation, but also and primarily he represents the creditors. An action such as this is distinctly for the benefit of the creditors, and not the corporation. A defense available against the corporation, arising out of the fact that the wrong complained of was the act of the corporation, is not available against innocent creditors of the corporation. Had there been no bankruptcy, and had the corporation conveyed its property without consideration in violation of the bulk sales law, or any other of the numerous laws enacted for the protection of creditors, no one would assert that the beneficiary of the wrong could defend an action by the creditors on the ground that the wrong complained of was the act of the corporation.

The intervening of the bankruptcy does not change this situation. The primary purpose of bankruptcy is to distribute the bankrupt estate, including property wrongfully conveyed by the bankrupt, ratably among the bankrupt's creditors. For this purpose numerous kinds of actions are permitted to be maintained by the trustee to recover property fraudulently conveyed by the bankrupt. We conceive this to be no different from these other cases of fraudulent transfers. In none of these other cases does the fact that the corporation has been guilty of a wrong prevent the trustee in bankruptcy from recovering for creditors property wrongfully transferred by the bankrupt. In no essential respect does this fraudulent transfer from the bankrupt to the defendant here differ from any of the other fraudulent conveyances

by bankrupts so frequently set aside by the Courts in actions by trustees in bankruptcy.

We think the Court has stressed too much, and perhaps been misled in its decision by, consideration of the fact that the trustee in bankruptcy also represents the bankrupt corporation. Incidentally he does represent the corporation, but only for the purpose of gathering the corporation's assets and distributing them among creditors. Bankruptcy acts, as well as all other insolvency acts, are primarily for the benefit of creditors, and to secure ratable distribution of assets among them. Incidentally, of course, the bankrupt benefits by being shielded from further claims of creditors. Actions, however, by the trustee in bankruptcy are not in furtherance of the benefit to the bankrupt, but in furtherance of the administration of the bankrupt's estate and for the benefit of creditors. So this action, prosecuted by the trustee in the course of the administration of the bankrupt's estate, is not in any sense for the benefit of the bankrupt, but rather for the benefit of the then and now existing creditors, who are innocent of wrong, and in fact defrauded by the act of the bankrupt.

We submit that the two major points touched upon by the opinion of the Court should have been resolved in favor of the appellant, that is, (1) that the Court is not deprived of jurisdiction by Section 606 of the Revenue Act, and (2) that the fact that the corporation was guilty of wrong is no defense to the action by the trustee representing creditors, they being in-

nocent of any wrong but defrauded thereby, and being the true beneficiaries of the action.

Dated, San Francisco,
February 24, 1932.

Respectfully submitted,
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Certificate of Counsel.

I hereby certify that I am of counsel for appellant and petitioner in the above entitled cause and that in my judgment the foregoing petition for a rehearing is well founded in point of law as well as in fact and that said petition for a rehearing is not interposed for delay.

Dated, San Francisco,
February 24, 1932.

C. H. Sooy,
Of Counsel for Appellant and Petitioner.